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Cases, Regulations and Statutes

Robert P. Achenbach Jr.
Agricultural Law Press, robert@agrilawpress.com

10 *Id*. at 1054.
11 *Id*.
12 *Id*. at 1055.
13 *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

HOSTILE USE. The land involved was originally one parcel but the owner divided the parcel into two equal parcels and sold the west half first. The new owner (west side owner) erected a fence on what the owner thought, as informed by the real estate agent, was the property line but which was actually 60 feet on to the owner's property. The owner did not otherwise improve the property and allowed the real estate agent to pasture cattle on the property. The east half of the property was purchased later with the fence already in place; therefore, the new owners (east side owners) also thought the fence was the actual boundary. The east side owners also did not improve their property and allowed the real estate agent to pasture horses on the property, including the disputed strip. The only other activity on the strip was watering by the sprinkler system by the east side owners. A flood cut away much of the west side property and carried away some of the fence and some of the disputed strip. The east side owners leased the house to the real estate agent as a residence and for a ranch for the agent's cattle. The cattle were tethered because of the broken fence. The east side owners then sold their parcel to the plaintiff through the same real estate agent, who informed the plaintiff that the fence was the true boundary. The plaintiff replaced the fence after the flood damage was restored. The west side parcel was then sold to the defendant with the former west side owner taking a deed of trust on the property. Three years later, the defendant had a survey done which finally showed that the fence was 60 feet on the west parcel and the plaintiff filed a quiet title action as to the defendant and as to the holder of the deed of trust. Although the plaintiff had clearly adversely possessed the disputed strip after their possession, the length of possession was insufficient to acquire title by adverse possession; therefore, the plaintiff needed to demonstrate adverse possession by the previous possessors. The defendant argued that because the real estate agent's lease of the land did not include using the land for cattle, the agent's use of the disputed strip could not be considered as adverse possession by the previous owners. The court held that the previous owners did not restrict the agent's use of the land; therefore, the agent's use of the disputed strip to graze tethered cattle was sufficient adverse possession to attribute that possession to the previous owner and could be tacked onto the plaintiff's adverse possession. The court also held, however, that the adverse possession did not include the portion of the disputed strip which was washed away in the flood, because no use of that portion was made by the agent and the washed away area became open range visited by cattle from several other ranches. The deed of trust holder argued that the adverse possession did not apply to the lien on the property. The court agreed that title by adverse possession could not accrue against the lienholder because the lien holder had no cause of action against the adverse possessor until the debtor defaulted on the loan. **Berryhill v. Moore, 881 P.2d 1182 (Ariz. Ct. App. 1994)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AVOIDABLE TRANSFERS. Prior to filing for bankruptcy, the debtor was involved in a suit against a manufacturer of cattle feed for damages resulting from defective feed. Prior to 90 days before filing for bankruptcy, the debtor assigned to a creditor a portion of the anticipated damages. The debtor received the damage award within the 90 days before filing for bankruptcy and the creditor received the portion of the award before the bankruptcy case commenced. The court held that the transfer to the creditor was not avoidable as a preferential transfer because the effective date of the transfer was the date the assignment of the damage award was executed, not the date the award was paid to the creditor. ***In re* Wagner, 173 B.R. 916 (N.D. Iowa 1994), *aff'g*, 144 B.R. 430 (Bankr. N.D. Iowa 1992)**.

ESTATE PROPERTY. The debtor's mother had created an inter vivos trust with a one-third remainder for the debtor. The mother died one month after the debtor filed for Chapter 7 and the debtor became entitled to one-third of the trust property. The debtor claimed the interest in the trust as exempt under Section 541(a)(5)(A), arguing that the trust property was not received "by bequest, devise or inheritance." The court held that recent U.S. Supreme Court and Second Circuit Court of Appeals rulings required a "plain meaning" interpretation of Section 541 and that receipt of property through a remainder interest in an inter vivos trust was not receipt of property by bequest, devise or inheritance. However, the court held that the debtor's interest in the trust was estate property under Section 541(a)(1) which included all interests in property held by the debtor. The holding is not clear as to whether the court intended that all of the debtor's share of the trust was included or just the value of the remainder interest at the time of the filing of the petition. ***In re* Crandall, 173 B.R. 836 (Bankr. D. Conn. 1994)**.

EXECUTORY CONTRACTS. The debtor entered into an installment contract to purchase a meat-processing business, including real and personal property and goodwill. The debtor received possession of all assets and the seller agreed to satisfy all existing liens against the property and to hold the debtor harmless for any liabilities which arose prior to the sale. The seller retained title to the property until all payments were made. The debtor initially filed a motion to assume the contract but the debtor's Chapter 12 plan provided for payments only to the extent of the value of the property, treating the contract as a security agreement. The seller argued that the debtor could not treat the contract as a security agreement in the plan once the contract had been assumed. The court held that the debtor was not estopped from changing the characterization of the contract because the seller had not detrimentally relied on the assumption of the contract. In addition, the court held that a debtor could not change the nature of the contract, if it was a security agreement, merely by assuming the contract; therefore, the only relevant issue was whether the contract was an executory contract or a security agreement. The court held that the installment contract was a security agreement because the only remaining duties were the payment of money by the debtor and the transfer of title by the seller. ***In re* Fitch, 174 B.R. 96 (Bankr. S.D. Ill. 1994)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtors filed for Chapter 7 and claimed a homestead exemption for their mobile home. The home was subject to several judgment liens but the debtors did not make any attempt to avoid the judicial liens against the homestead. After the case was closed, the debtors sold the mobile home. The closing company paid the proceeds to the judgment creditors and the debtor petitioned the Bankruptcy Court to reopen the case to allow avoidance of the judicial liens. The court held that because the homestead proceeds had been distributed to the creditors, the judicial liens could no longer be avoided. **In re Kudrna, 173 B.R. 934 (Bankr. D. Idaho 1994)**.

The debtor claimed a homestead exemption and sought to avoid a judgment lien against the house. The Bankruptcy Court had avoided the entire $92,000 lien, although the exemption amount was only $12,000. The creditor argued that the house was already exempt from the lien under Utah law; therefore, no impairment existed. The District Court reversed, holding that the homestead exemption was not impaired because the lien could not affect the homestead exemption under state law. In addition, the court held that the entire lien could not be avoided but that the lien could have been avoided only to the extent of the impaired exemption amount. The Tenth Circuit Court of Appeals affirmed on both points. ***In re* Sanders, 39 F.3d 258 (10th Cir. 1994), *aff'g*, 156 B.R. 667 (D. Utah 1993)**.

HOUSEHOLD GOODS. The debtors claimed a variety of household items as exempt under Idaho Code § 11-605(a)(1). Using a "reasonably necessary" standard, the court allowed one VCR, one television, patio furniture, an entertainment cabinet, and a stereo as exempt household goods. The court did not allow an exemption for sport equipment, a second VCR, two other televisions, and one computer system. The court noted that in 1989 VCRs were considered luxury items but that in 1994, the use of VCRs was so pervasive as to make at least one VCR a necessity in a household. Query, how soon will computers change from luxury items to necessities? The court did allow a tools of the trade exemption for another computer system because the debtor's employer provided the debtor with software for the computer so that the debtor could perform some employment duties at home, even though the computer and home work were not required as a condition of employment. ***In re* Biancavilla, 173 B.R. 930 (Bankr. D. Idaho 1994)**.

TRUSTEE FEE. The debtor owned a farm which was subject to two deeds of trust. The debtor filed for Chapter 11 and sold the farm under approval of the Bankruptcy Court. The sale proceeds were paid to the first deed of trust holder and the remainder of the proceeds were distributed through an escrow account administered by the debtor's attorney. The case was then dismissed with the court ordering payment of a $400 trustee fee under 28 U.S.C. § 1930 because the only disbursements were made directly to secured creditors. The District Court reversed, holding that "disbursements" under Section 1930 included all payments made from the estate. **St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525 (9th Cir. 1994)**.

CHAPTER 11-*ALM* § 13.03.*

ABSOLUTE PRIORITY RULE. The debtors operated a cattle-on-gain operation which included renting pasture to a third party. The debtors' Chapter 11 plan provided for payment of 52 percent of the unsecured claims and retention of the debtors' farm. The plan provided that the pasture lessee would make all due rent payments immediately to infuse the operation with almost $70,000 in cash. An unsecured creditor objected to the plan as violating the absolute priority rule because the debtors were retaining property but paying only 52 percent of unsecured claims. The debtor argued that the $70,000 payment was new capital invested by the debtors. The court held that the absolute priority rule was not satisfied because the due lease payments were already estate property and could not qualify as new investment by the debtors. ***In re* Short, 173 B.R. 946 (Bankr. E.D. Okla. 1994)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

CLAIMS. The debtor had filed a previous Chapter 13 case which was dismissed without discharge. The IRS filed a claim for taxes in the second case and included interest accrued during the first bankruptcy case. The debtor objected to the portion of the claim for interest during the first case. The court held that the dismissal of the first case without discharge put the debtor and all creditors in the same position as if no previous case had been filed; therefore, the interest which accrued during the previous case was allowable. ***In re* Irons, 173 B.R. 910 (Bankr. E.D. Ark. 1994)**.

The debtors claimed a homestead exemption for a mobile home located on their real property and which was subject to federal tax liens. The debtors argued that the tax liens should be "stripped down" to the value of their equity in the home. The court held that, under *Dewsnup v. Timm, 502 U.S. 410 (1992)*, the lien could not be reduced to the value of the collateral. **In re Place, 173 B.R. 912 (Bankr. E.D. Ark. 1994)**.

CONTRACTS

BREACH. The defendant owned farm land in Nebraska and entered into a written contract with the plaintiff for the plaintiff to operate the farm. The contract provided for a per acre fee plus a share of the profits. The contract also provided for written extensions and the contract was extended three times. In the fourth year, the farm incurred substantial losses and the defendant notified the plaintiff that the contract would be terminated, paid the plaintiff

$1,000 and provided no written extension of the contract. However, the defendant allowed the plaintiff to finish harvesting the crop that year and orally agreed to allow the plaintiff to operate the farm an additional year on a fee per acre basis only. The plaintiff sued for breach of contract in that the defendant did not pay the entire fee per acre nor any share of the profits. The plaintiff argued that the original contract was extended by the oral agreements. The court held that the original contract liability of both parties was resolved by an accord and satisfaction. The court also held that the original contract was not extended by the oral agreements because the contact provided that an extension could be made only in writing and both parties provided partial performance in accord with the oral agreement. The court upheld the defendant's counterclaim for damages under the oral contract because the evidence showed that the crop losses resulted from the plaintiff's failure to plant early enough, to irrigate the crops and to control weeds. The defendant's losses were offset only by the amount of per acre fee not paid by the defendant. **Lone Cedar Ranches, Inc. v. Jandebeur, 523 N.W.2d 364 (Neb. 1994)**.

PASTURE LEASE. The plaintiff owned pasture land and had agreed to allow the defendant's corporation to pasture the corporation's horses on the pasture. The agreement was not put in writing and when the defendant removed horses without paying the rent, the plaintiff sued for the rent. The defendant argued that the lease was void because it was not in writing. The court held that the agreement did not amount to a lease of land because the agreement did not transfer any interest in the property to the defendant. In addition, the court held that the statute of frauds would not apply because of partial performance of the agreement by the parties. The trial court had awarded damages against the sole shareholder of the defendant corporation and the defendant argued on appeal that only the corporation was liable for the rent. The court held that the trial court properly ignored the corporation because the defendant, as demonstrated by the defendant's own testimony, completely controlled the corporation and did not treat it as a separate entity from the defendant's property. **Ferguson v. Strader, 641 N.E.2d 728 (Ohio Ct. App. 1994)**.

FEDERAL AGRICULTURAL PROGRAMS

PEANUTS. The CCC has issued proposed regulations establishing the minimum CCC sales price for 1995 crop of additional peanuts for export at $400 per short ton. **60 Fed. Reg. 381 (Jan. 4, 1995)**.

RURAL DEVELOPMENT. The defendant village obtained a loan from the FmHA (now CFSA) for the repair of its water treatment facility. Under regulations governing such loans, the defendant enacted a loan resolution agreeing to provide adequate service to all persons in the service area and agreeing to obtain FmHA prior consent before refusing new or existing service to such persons. The defendant sought to increase the size of the village in order to qualify as a city and passed an ordinance requiring nonresident water customers to annex their property to the village in order to continue receiving water and sewage service. The plaintiffs were nonresidents in the water service area who were denied existing or new water service because of their refusal to annex their property to the village. The court held that the annexing ordinance violated the loan resolution and allowed the plaintiffs to sue for damages including attorney's fees. **Wayne v. Village of Sebring, 36 F.3d 517 (6th Cir. 1994)**.

FEDERAL ESTATE AND GIFT TAX

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* A trust was established in 1970 by the will of the taxpayers' grandfather. The trust had the taxpayers' parent as life beneficiary and when that parent died, the trust beneficial interest passed equally to the four taxpayers. The trust provided that if the income was insufficient to meet the needs of a beneficiary, the trustee could distribute trust corpus to that beneficiary. The taxpayers divided the trust into four trusts, one for each taxpayer. The resulting trusts were identical to the original trust, including a provision that the corpus of each trust could be invaded to support any beneficiary of the trusts if the income of the separate trust was insufficient to meet the needs of that beneficiary. The original trust assets were distributed under state law which required distribution based on the fair market value of the trust assets and required distribution which fairly represented the capital gain or loss accumulated on the assets. The distribution of assets, however, did not equally divide each asset. The IRS ruled that the partition of the trust did not subject the pre-1986 trust to GSTT nor did the taxpayers realize any gain or loss from the partition. **Ltr. Rul. 9451065, Sept. 28, 1994**.

The decedent had created several trusts for the decedent's grandchildren and the grandchildren merged the trusts so that each child was the beneficiary of one trust instead of several trusts. The remaining trust retained the same terms as the original trusts as to the assets involved in the original trusts. The IRS ruled that the merger of the trusts did not result in recognition of gain or loss to the beneficiaries, did not affect the basis or holding periods of the trust assets and did not subject the trusts to GSTT. **Ltr. Rul. 9452033, Sept. 30, 1994**.

GIFT-*ALM* § 6.01.* The taxpayers were sisters and were each a beneficiary of a trust established by their parent. The trusts were interpreted by a state court to give each beneficiary the inter vivos power to require the distribution of all income and principal to the beneficiary's descendants or descendants of the parent, but not the beneficiary. The taxpayers each requested the trustee of their trusts to distribute the trust assets to the other sister. The IRS ruled that because the taxpayers did not have the power to require distributions of trust income and principal to the taxpayers' themselves, their estates or their creditors, the taxpayers did not possess general powers of appointment over trust property. However, because each taxpayer had a beneficial interest in the trust, the right to periodic distributions of income and principal, the distributions to the other taxpayer were taxable gifts to the extent of the value of these beneficial interests. The IRS noted that the facts of this case did not require application of the reciprocal transfer rules under *United State v. Estate of Grace, 395 U.S. 316 (1969).* **Ltr. Rul. 9451049, Sept. 22, 1994**.

A number of family trusts owned 48 percent of the common stock of a corporation. The trusts exchange the common stock with a value of over $3.7 million for preferred stock with a value of just over $780,000. The remainder of the common stock was owned by one son. The Court held that the recapitalization of the corporation resulted in a gift to the son of the difference between the value of the trusts' stock before and after the recapitalization because the recapitalization was made with donative intent and was controlled by the family members. **Saltzman v. Comm'r, T.C. Memo. 1994-641**.

TRANSFERS WITH RETAINED INTERESTS-*ALM* § 5.02[4].* The decedents, husband and wife, had made inter vivos transfers of remainder interests in three properties to their daughter for a small amount of cash and a promissory note. The amount of cash and the face value of the notes did not equal the fair market value of the properties transferred. The court held that, under I.R.C. § 2603(a), because the decedents did not receive the full value of the transferred properties at the time of the transfers, the value of the properties was included in the decedents' gross estates less the amount of consideration actually received. **Pittman v. U.S., 95-1 U.S. Tax Cas. (CCH) ¶ 60,186 (E.D. N.C. 1994)**.

VALUATION. The taxpayers, members of one family, had formed a limited partnership with three classes of limited partnership interests and each member holding one type of limited interest as well as a general partner interest. The partnership owned three parcels of real estate. The three parcels were transferred to three separate limited partnerships, each with the same set of interests as the original partnership. Each new partnership had one family member as limited partner, with the partner contributing the limited partnership interest in the original partnership to the new partnership. The partner in each new partnership also formed a corporation and contributed the general partnership interest in the original partnership to the corporation which contributed its stock to the new partnership in exchange for a general partnership interest. Thus, each new partnership had one limited partner who was the director and sole shareholder of a corporate general partner and each new partnership owned one parcel of real estate. The new partnerships had terms identical to the original partnership and were required to contribute to each other if income was insufficient to meet the distribution requirements of the partnership agreements. The IRS ruled that the transaction was only a de minimis change in the rights and liabilities of the original partners; therefore, I.R.C. §§ 2701, 2703, 2704 did not apply to the transactions. **Ltr. Rul. 9451050, Sept. 22, 1994**.

The taxpayer had loaned money to a corporation in exchange for promissory notes. In exchange for cancelling some of those notes, the taxpayer received shares of Class A noncumulative, convertible preferred stock in the corporation. The preferred stock had the same rights to dividends as the common stock, had the same one vote per share voting rights, was convertible at any time to an equal number of common stock shares, and received a liquidation preference of $10 per share, which was subtracted from the stock's pro rata share of any liquidation proceeds remaining after the preference distribution. The taxpayer also owned common stock. The IRS ruled that the preferred stock was substantially the same as the common stock since both classes had the same voting and dividend rights; therefore, I.R.C. § 2701 did not apply to the transaction. The $10 per share liquidation preference right was evidently an insufficient difference for purposes of Section 2701. **Ltr. Rul. 9451051, Sept. 23, 1994**.

The decedent had transferred a one-half interest in a shopping center to the decedent's children. The other one-half interest had been sold by third parties in an arm's-length sale five months before the transfer to the children. The court held that the value of the transferred interest would be based on the sale of the other half. Two of the decedent's children obtained a deed from the decedent for two orange groves. The estate sued the children for return of the property, based on undue influence, and eventually recovered the groves. The estate argued that the estate tax value of the groves was only the value of the claim against the children and discounted the fair market value by 50 percent. The court ruled that the discount would only be 25 percent because the estate had a good chance of winning the suit, based on the evidence available to the estate. **Estate of Sharp v. Comm'r, T.C. Memo. 1994-636**.

FEDERAL INCOME TAXATION

BAD DEBTS-*ALM* § 4.03[7].* The taxpayer had made over $325,000 in loans to a bank in which the taxpayer was president and an 85 percent owner. The taxpayer claimed a bad debt deduction for the loan. The court held that the bad debt was not eligible for a business bad debt deduction because the taxpayer's motive in making the loans was to protect the taxpayer's investment in the bank and not the taxpayer's employment. ***In re* Pierce, 94-2 U.S. Tax Cas. (CCH) ¶ 50,627 (Bankr. E.D. Okla. 1994)**.

C CORPORATIONS

REORGANIZATIONS. The IRS has issued a ruling that it will not issue advance rulings as to the tax consequences of Section 368 transactions in which one corporation owns stock in a second corporation but is not an 80 percent distributee of the second corporation under I.R.C. § 337(c) and the two corporations are merged. **Rev. Rul. 94-76, I.R.B. 1994-52**.

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[14].* After being discharged from the taxpayer's job as a steel worker for fighting, the taxpayer sued the worker's union for breach of duty of fair representation and obtained a judgment and award against the union. The court held that the award was excludible from the taxpayer's income because the action involved tort-like claims for personal injury. **Banks v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,630 (W.D. Wash. 1994)**.

EMPLOYEE EXPENSES. The IRS has issued revised procedures for deemed substantiation of employee expenses for lodging, meals and other traveling expenses where the employer provides a per diem allowance allowance for expenses. The revised procedures also provide an optional method for employers and self-employed individuals to compute the deductible costs of business meals and other travel expenses. **Rev. Proc. 94-77, I.R.B. 1994-52, 51, *superseding*, Rev. Proc. 93-50, 1993-2, C.B. 586**.

EARNED INCOME CREDIT. The IRS has announced that the earned income tax credit in 1995 is available for low income childless workers with income less than $9,000 ($306 credit allowed) and that the maximum credit has been increased to $2,038 with one qualifying child and $2,528 with more than one child. **IRS Fact Sheet FS-94-9, Dec. 28, 1994**.

INSTALLMENT PAYMENT OF TAXES. The IRS has announced proposed regulations imposing a fee of $43 for new agreements for installment payment of delinquent income taxes and $24 for restructuring or reinstating an installment agreement. **IR 94-118, Dec. 27, 1994**.

LETTER RULINGS. The IRS has issued its annual list of procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices. **Rev. Proc. 95-2, I.R.B. 1995-1, 64**.

The IRS has issued its annual list of tax issues for which the IRS will not give advance rulings or determination letters. **Rev. Proc. 95-3, I.R.B. 1995-1, 85**.

The IRS has issued procedures for issuing determination letters on the qualified status of employee plans under Sections 401(a), 403(a), 409 and 4975(e)(7). **Rev. Proc. 95-6, I.R.B. 1995-1, 153**.

The IRS has issued revised fee schedules for issuing determination letters on the qualified status of employee plans under Sections 401(a), 403(a), 409 and 4975(e)(7). **Rev. Proc. 95-8, I.R.B. 1995-1, 187**.

MILEAGE DEDUCTION. The standard mileage rate for 1995 is 30 cents per mile for business use, 12 cents per mile for charitable use and 9 cents per mile for medical and moving expense use. **Rev. Proc. 94-73, I.R.B. 1994-52, 23**.

PASSIVE ACTIVITY LOSSES-*ALM* § 4.05[3].* Effective for taxable years beginning after December 31, 1993, rental real estate activities in which the taxpayer materially participates are not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services. See I.R.C. § 469(c)(7). An individual meets the requirements if (a) more than one-half of the personal services the taxpayer performs in trades or businesses during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates and (b) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. See I.R.C. § 469(c)(7)(B). A “real property trade or business” includes any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. See I.R.C. § 469(c)(7)(C). The IRS has announced proposed regulations implementing these rules. **Jan. 10, 1995**.

Under Treas. Reg. § 1.469-2T(c)(3)(ii)(A), if a member of a passthrough entity, such as a partnership or S corporation, sells, exchanges or otherwise disposes of an interest in the entity, a ratable portion of the gain or loss recognized from the transfer of the interest in the entity is allocated to each activity of the entity in order to determine how much of the gain or loss is attributable to passive activities. The IRS has issued a ruling that if a partner or member of an S corporation receives a distribution in excess of the member’s basis in the entity, the excess is to be treated as a sale or exchange of an interest in the entity for purposes of the passive activity rule of Treas. Reg. § 1.469-2T(c)(3)(ii)(A). **Rev. Rul. 95-5, I.R.B. 1995-2**.

PARTNERSHIPS-*ALM* § 7.03.*

CONTRIBUTIONS. The IRS has adopted as final regulations relating to the allocation of built-in gain or loss in property to the partner who contributed the property. In general, the regulations require the use of a reasonable allocation method which takes into account the variation between the adjusted tax basis of the property and its fair market value. The regulations provide methods considered reasonable but allow taxpayers to use another method if, under the facts and circumstances, the method is reasonable. The regulations specifically define as unreasonable an allocation method which increases or decreases the property's basis or where the partnership creates tax allocations of income, gain, loss or deduction independent of allocations affecting book capital accounts. The new regulations provide guidance for using the remedial allocation method and for allocation regarding securities and similar investments. **59 Fed. Reg. 66724 (Dec. 28, 1994)**.

DEFINITION. The IRS has adopted as final regulations providing an anti-abuse rule which allows the IRS to recast a transaction involving a partnership as a transaction more accurately reflecting the true nature of the transaction. **60 Fed. Reg. 23 (Jan. 3, 1995), *adding* Treas. Reg. § 1.701-2**.

The IRS has published a list of all states whose version of the Revised Uniform Limited Partnership Act conforms to the Uniform Limited Partnership Act for purposes of Treas. Reg. § 301.7701-2. **Rev. Rul. 95-2 I.R.B. 1995-1, 7**.

LIMITED LIABILITY COMPANIES. The IRS has issued proposed regulations which provide that a member’s share of income or loss of an LLC is self-employment income unless (1) a member is not a manager and (2) the LLC would qualify as a limited partnership under the limited partnership law of the state in which the LLC is organized and the member would qualify as a limited partner. If a member meets these requirements, the member’s share of LLC income and loss is not self-employment income unless the distributions to the member are guaranteed payments for services. A manager is defined as a person who, alone or with others, has the continuing exclusive authority to make the management decisions necessary to conduct the business of the LLC. If no member is designated as a manager, all of the members are managers, even if some members have more authority than others. **59 Fed. Reg. 67253 (Dec. 29, 1994), adding Prop. Treas. Reg. § 1.1402(a)-18**.

PENALTIES. The IRS has issued proposed regulations concerning whether the reliance on the advice of a professional tax advisor will qualify the taxpayer for reduction in the accuracy penalty of I.R.C. § 6662. The proposed regulations require that the advice of the tax professional be based on all material facts, including the taxpayer's purpose for entering the transaction, and cannot be based on unreasonable factual or legal assumptions, including future events. **60 Fed. Reg. 406 (Jan. 4, 1995), amending Treas. Reg. § 1.6662-4(g)**.

PENSION PLANS. The IRS has announced the 1995 cost-of-living adjustments applicable to dollar limitations on benefits under qualified defined benefit pension plans. **IR 94-117, Dec. 23, 1994**.

PREPRODUCTION EXPENSES. The IRS has adopted as final rules governing the capitalization of preproduction interest on all real property (includes crops with a preproductive period of more than two years) and personal property with a class life of 20 years or more, an estimated preproduction period of more than two years, or an estimated production period of more than one year and an estimated cost of production of more than $1 million. The amount of interest required to be capitalized is to be determined under the cost avoidance method. The rules are effective for taxable years beginning after December 31, 1994. **59 Fed. Reg. 67187 (Dec. 29, 1991), adding Treas. Reg. §§ 1.263A(f)-1 through 1.263A(f)-9**.

S CORPORATIONS-*ALM* § 7.02[3[c].*

BUILT-IN GAINS. The IRS has adopted as final regulations governing the recognition of built-in gains and losses for S corporations which made an S corporation election after December 31, 1986.

The regulations provide that I.R.C. §§ 1374(d)(3), (4) (gain recognized during recognition period is presumed to be recognized built-in gain or loss) apply only to gain and loss recognized from sales and exchanges. **Treas. Reg. § 1.1374-4(a)**.

An S corporation's items of income or deduction generally are treated as built-in gain or loss if the item would have been taken into account before the recognition period by a taxpayer using the accrual method. **Treas. Reg. § 1.1374-4(b)**.

The regulations provide rules for recognized built-in gain or loss for (1) positive and negative income adjustments under I.R.C. § 481(a), (2) cancellation of indebtedness income and bad debt deductions, (3) income from sales or exchanges reported under the installment method, and (5) the distributive share of partnership items. **Treas. Reg. §§ 1.1374-4(c) through (h)**.

The regulations provide rules for determining recognized built-in gain and loss when an S corporation holds an interest in a partnership. **Treas. Reg. § 1.1374-4(h)**. **59 Fed. Reg. 66458 (Dec. 27, 1994)**.

SHAREHOLDER BASIS. The taxpayer owned 96 percent of a C corporation with the taxpayer's spouse. The taxpayer loaned $34,000 to the C corporation for product development. The taxpayer and spouse then established an S corporation to sell the product developed by the C corporation. The S corporation paid the C corporation for the services by a promissory note. The promissory note was extinguished when the S corporation agreed to assume the C corporation's liability to the taxpayer. The court held that the taxpayer could not add the amount of the loan to the taxpayer's basis in the S corporation because the loan was between the taxpayer and the C corporation. **Hitchins v. Comm'r, 103 T.C. No. 40 (1994)**.

SOCIAL SECURITY TAX. The IRS has issued guidelines in question and answer form for determining when tip income is subject to FICA tax and withholding. **Rev. Rul. 95-7, I.R.B. 1995-4**.

NEGLIGENCE

AERIAL SPRAYING. The plaintiff leased land neighboring land planted in soybeans. The plaintiff grew watermelons which were healthy until two weeks after the defendant sprayed the soybean fields with herbicides. The plaintiff claimed that the spraying was done negligently and caused the loss of the melons, although the plaintiff presented no soil tests or plant residue tests to support the allegations. The plaintiff argued that the spraying was an inherently dangerous activity shifting the burden of proof to the defendant. The court held that the "inherently dangerous activity" doctrine was available only to impose liability on a land owner for the activities of an independent contractor on the owner's land. The plaintiff also argued that the trial court's ruling in favor of the defendant was against the weight of the evidence because under the "sudden onset doctrine." the spraying had to have caused the loss of the melons. The court held that the "sudden onset doctrine" did not apply because the plaintiff's melons did not die until two weeks after the spraying and the plaintiff did not show that the spraying was negligently performed. In addition, the court noted that several other explanations for the death of the melons were presented at trial, including carryover of herbicide from the plaintiff's own spraying on the previous year's soybean crop. **McLain v. Johnson, 885 S.W.2d 345 (Mo. Ct. App. 1994)**.

SECURED TRANSACTIONS

PERFECTION. The debtors had granted to the plaintiff a security interest in "all crops growing or to be grown." The financing statement was filed in Fulton county where the debtors had farm land on which crops were grown. The debtors also grew crops on farm land in Henry county and one crop was sold during the debtors' bankruptcy case. The plaintiff claimed a priority security interest in the crops under the Fulton county filed security agreement. Another creditor and the bankruptcy trustee, the defendant, objected to the plaintiff's security interest, arguing that the security interest was not perfected because the financing statement did not describe any land in Henry county and because the financing statement was not filed in Henry county. The court held that the security interest was not perfected because the financing statement was not filed in the county where the crops were grown as required by Ohio Rev. Code § 1309.38(A)(2) for security interests in crops growing or to be grown. The court did not discuss the requirement for description of the land on which the crops were grown. **Farm Credit Services v. Nofzinger, 642 N.E.2d 430 (Ohio Ct. App. 1994)**.

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TRESPASS

DAMAGES. The defendant cooperative electric company had electric lines running over the plaintiff's property to provide electrical service to the plaintiff. The defendant entered onto the plaintiff's property and trimmed three trees with branches in the lanes. The plaintiff sued for excess trimming of the trees. The defendant argued that the actual damages were to be based upon the loss of value of the land and objected to the trial court's instructions which allowed the jury to base the damages on either the cost of replacement of the trees, the loss of shade or ornamental value of the trees, or the loss of aesthetic value of the trees. The plaintiff presented evidence of methods of appraisal of damaged trees approved by the Council of Tree and Landscape Appraisers which is accepted and distributed by the U.S.D.A. through the Cooperative Extension Service. The court held that the jury instruction was proper and that the plaintiff provided sufficient evidence of an appraisal method for use by the jury. The defendant objected to the award of treble damages because the defendant believed that it was on the property with the good faith belief that it had an easement to trim tree branches in the wires. The court held that S. D. Cent. Laws § 21-3-10 did not provide any "good faith" exception to allowing treble damages for wrongful injury to trees. **Wallahan v. Black Hills Elec. Co-op., Inc., 523 N.W.2d 417 (S.D. 1994)**.

ISSUE INDEX